No. 8429.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

12

Federal Housing Administrator, on behalf of the United States of America,

Appellant,

vs.

Wm. H. Moore, Jr., as Trustee in Bankruptcy of the Estate of Pioneer Auto Laundry, a corporation, Bankrupt,

Appellee.

APPELLEE'S BRIEF.

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SUBJECT INDEX.

PAGE

The Statement ... 4

Argument ... 5

The Question of Sovereignty ... 12

Conclusion ... 17

TABLE OF AUTHORITIES CITED.

Cases.

PAGE

Acme Harvester Co. v. Beekman, 222 U. S. 300, 27 Am. B. R. 262 10

Bennet, In re, Trustee of the Hume Cooperage Co., 156 Fed. 173, 18 Am. B. R. 320 10

Buchanan v. Bowen, 111 U. S. 776 10

Campbell, Re, 102 Fed. 686, 4 Am. B. R. 535 (Dist. Ct. Wis.) 11

Dutcher, Matter of, 213 Fed. 908, 32 Am. B. R. 545 (Dist. Ct. Wash.) 11

Eastern Shore Ship Building Corporation, Bankrupt, Matter of, 274 Fed. 893, 48 Am. B. R. 110 14

Everett v. Judson, 228 U. S. 74, 30 Am. B. R. 1 10

Fairbanks Steam Shovel Co. v. Wills, 240 U. S. 642, 36 Am. B. R. 754 10

Fuller v. Bennett, 152 Fed. 538, 18 Am. B. R. 443 (Dist. Ct. W. Va.) 11

Harmon, Matter of, 128 Fed. 170, 11 Am. B. R. 64 (Dist. Ct. W. Va.) 11

Hiscock v. Varick Bank, 206 U. S. 28, 18 Am. B. R. 1 10

Howe v. Sheppard, 2 Summ. 133 11

North Carolina Car Co., In re, 127 Fed. 178, 11 Am. B. R. 588 (Dist. Ct. N. C.) 11

Partridge Lumber Co., In re, 215 Fed. 973, 33 Am. B. R. 539 11

Sexton v. Dreyfus, 219 U. S. 339, 25 Am. B. R. 363 .... 6, 7

Shropshire, Woodliff & Co. v. Bush, et al., Trustees, 204 U. S. 186, 17 Am. B. R. 77 .... 9, 10

Sloan Shipyards Corp. et al. v. United States Shipping Board Emergency Fleet Corporation, et al., 258 U. S. 459, 42 Sup. Ct. 386, 48 Am. B. R. 249 .... 13, 16

PAGE

Trust Co. v. Walker, 107 U. S. 596 10

United States Bank v. Planters Bank of Georgia, 9 Wheat. 904, 6 L. Ed. 244 15

United States v. Wood, 290 Fed. 109, 1 Am. B. R. (N. S.) 44, 263 U. S. 680 16

Statutes.

Bankruptcy Act, Sec. 57 (i) (11 U. S. C. A., Sec. 93 (i)) 4, 5, 7, 17, 18

Bankruptcy Act, Sec. 63 (a) (11 U. S. C. A., Sec. 103 (a)) 4, 5

Bankruptcy Act, Sec. 64 (a), Sec. 64 (b) (11 U. S. C. A., Sec. 104 (a), (b)) 4, 5, 8

Bankruptcy Act, Sec. 65 (a) (11 U. S. C. A., Sec. 105 (a)) 4, 5

Bankruptcy Act, Sec. 65 (e) (11 U. S. C. A., Sec. 105 (e)) 4, 5

National Housing Act, Title 12, Secs. 1702, 1703, 1705 and 3466 of the Revised Statutes; 31 U. S. C. A., Sec. 191 4

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vs.

Wm. H. Moore, Jr., as Trustee in Bankruptcy of the Estate of Pioneer Auto Laundry, a corporation, Bankrupt,

Appellee.

APPELLEE'S BRIEF.

There is no controversy between the Government and the trustee regarding either the jurisdiction of the court or of the questions presented, but counsel for the appellee feel that there should be some slight amplification of the Government's statement of the statutes involved and of the facts.

In addition to the National Housing Act, Title 12, Sections 1702, 1703, 1705, and 3466 of the Revised Statutes; 31 U. S. C. A., Section 191, there are also involved sections of the Bankruptcy Act of the United States of 1898, as follows:

Bankruptcy Act, Section 57 (i) (11 U. S. C. A., Sec. 93 (i));

Bankruptcy Act, Section 64 (a), Section 64 (b) (11 U. S. C. A., Sec. 104 (a), (b));

Bankruptcy Act, Section 65 (a) (11 U. S. C. A.. Sec. 105 (a));

Bankruptcy Act, Section 65 (e) (11 U. S. C. A., Sec. 105 (e));

Bankruptcy Act, Section 63 (a) (11 U. S. C. A., Sec. 103 (a));

THE STATEMENT.

There is no question raised as to the correctness of the Government's statement of facts as set out, except for the fact that we believe the statement that the Federal Housing Administrator paid the claim of the Seaboard National Bank against the bankrupt, in full, on September 27, 1935, should have been amplified by stating that the petition in bankruptcy was filed on July 9, 1935, three months before payment by the Federal Housing Administration of the debt. [Tr. of Rec. p. 24.]

ARGUMENT.

Section 63 (a) of the Bankruptcy Act, in so far as material here, reads as follows:

> "Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by * * * an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not."

Section 57 (i) of the Bankruptcy Act, reads as follows:

> "Whenever a creditor, whose claim against a bankrupt estate is secured by the individual undertaking of any person, fails to prove such claim, such person may do so in the creditor's name, and if he discharge such undertaking in whole or in part he shall be subrogated to that extent to the rights of the creditor."

Section 65 (a) of the Bankruptcy Act, reads as follows:

> "Dividends of an equal per centum shall be declared and paid on all allowed claims, except such as have priority or are secured."

Section 65 (e) of the Bankruptcy Act, reads as follows:

> "A claimant shall not be entitled to collect from a bankrupt estate any greater amount than shall accrue pursuant to the provisions of this Act."

It is to be borne in mind that the petition in bankruptcy was filed in this case on July 9, 1935, as set forth in the Referee's Certificate on Review [Tr. of Rec. p. 24], which has been stipulated by counsel for the trustee and the United States attorney to be regarded as true in this court. [Tr. of Rec. p. 31.] On that date what was the status of the bankrupt's liability? There is no question

but that it was indebted to the Seaboard National Bank, a private corporation, in the sum of $1579.78. Had it been possible to have elected a trustee and liquidated the estate in one day's time the claim of the Seaboard National Bank would have been filed as a general claim for $1579.78, allowed on that basis, and a dividend of equal per centum with other creditors have been paid under Section 65 (a) of the Bankruptcy Act.

As was said by Mr. Justice Holmes in *Sexton v. Dreyfus,* 219 U. S. 339; 25 Am. B. R. 363:

> "If, as in a well known illustration of Chief Justice Shaw's (Parks v. Boston, 15 Pick. 198, 208), the whole matter could be settled in a day by a pie-powder court, the secured creditor would be called upon to sell or have his security valued on the spot, would receive a dividend upon that footing, would suffer no injustice, and could not complain. If, under Section 57 of the present Act the value of the security should be determined by agreement or arbitration, the time for fixing it naturally *would be the date of the petition.* At that moment the creditors would acquire a right *in rem* against the assets. Chemical National Bank v. Armstrong, 28 L. R. A. 231, 8 C. C. A. 155, 16 U. S. App. 465, 59 Fed. 372, 378, 379; Merrill v. National Bank, 173 U. S. 131, 140, 19 Sup. Ct. 360." (Italics ours.)

The case of *Sexton v. Dreyfus, supra,* in our opinion, settles the question here. We quote the applicable extracts therefrom:

> "For more than a century and a half the theory of the English bankrupt system has been that everything stops at a certain date. Interest was not computed beyond the date of the commission. *Ex parte* Bennet, 2 Atk. 527. This rule was applied to mort-

gages as well as to unsecured debts (*Ex parte* Wardell, 1787; *Ex parte* Hercy, 1702, 1 Cooke, Bankruptcy Laws, 4th Ed. 181 (1st Ed. Appx.); and notwithstanding occasional doubts it has been so applied with the prevailing assent of the English judges ever since. (*Ex parte* Badger, 4 Ves. Jr. 165; *Ex parte* Ramsbottom, 2 Mont. & A. 79; *Ex parte* Penfold, 4 De G. & S. 282; *Ex parte* Lubbock, 9 Jur. N. S. 854; *Re* Savin, L. R. 7 Ch. 760, 764; *Ex parte* Bath, L. R. 22 Ch. Div. 450, 454; Quartermaine's Case (1892), 1 Ch. 639; *Re* Bonacino, 1 Manson, 59). As appears from Cook, *supra,* the rule was laid down, not because of the words of the statute, but as a fundamental principle. We take our bankruptcy system from England, and we naturally assume that the fundamental principles upon which it was administered were adopted by us when we copied the system, somewhat as the established construction of a law goes without words where they are copied by another state. * * * The rule under discussion fixes the moment in all cases *at the date which the petition is filed.*" (Italics ours.)

Although the case of *Sexton v. Dreyfus* dealt with the question of the rights of a secured creditor, by analogy, in our opinion, the rule is the same. The rights of a creditor holding security under Section 57 (h) do not deprive the general creditors of the bankrupt of any greater or any lesser rights and advantages of position than do the rights of a creditor accorded priority under the provisions of Section 64.

It is our contention that the Seaboard National Bank at the date of the filing of the petition, was a general claimant against the bankrupt estate; that if it had filed its claim the Federal Housing Administration would not have been permitted, under Section 57 (i), to have filed

any claim at all, and certainly by no stretch of the imagination could the Seaboard National Bank have been permitted to have filed a prior claim under subdivision (7) of Section 64 (b), on the ground that its claim had been guaranteed as to payment, by the Federal Housing Administration. That being the case, we respectfully submit that by paying the claim after the filing of the petition and filing in its own name instead of in the name of the creditor, as required under the plain provisions of Section 57 (i), the Federal Housing Administration cannot convert what constituted nothing more nor less than a general unsecured claim at the date of the filing of the petition, into a prior claim as against the rights of other creditors.

An examination of the authorities covering the reverse of the rule will illustrate the logic of our position.

Section 64 (b), subdivision (5) of the Bankruptcy Act gives priority to:

> "Wages due to workmen, clerks, traveling or city salesmen, or servants, which have been earned within three months before the date of the commencement of the proceeding, not to exceed $600 to each claimant."

Let us assume that a workman, servant or clerk had earned $600.00 within three months prior to the commencement of the proceedings, had needed money badly and could not afford to await the distribution of the dividends in the bankrupt estate and discounted his claim to a finance company for fifty per cent of its value, and the finance company proceeded to file a claim for $600.00 against the bankrupt estate asserting priority. Could it be said that by reason of the fact that the claim filed by the finance company was not for wages earned by it

within three months prior to the filing of the petition, the claim could only be allowed as a general claim?

In *Shropshire, Woodliff & Co. v. Bush, et al., Trustees,* 204 U. S. 186; 17 Am. B. R. 77, the Supreme Court of the United States settled this question. Shropshire, Woodliff & Co. had acquired a large number of claims for wages of workmen and servants, none of them exceeding $300.00 in amount, and all were within three months before the date of the commencement of the proceedings. The District Court disallowed the claims as prior, on the ground that, when filed, they were not due to workmen, clerks or servants. The Circuit Court of Appeals for the Sixth Circuit certified the question to the Supreme Court. In reversing the ruling of the District Court, the Supreme Court of the United States said:

> "The precise inquiry is whether the right of prior payment thus conferred is attached to the person or to the claim of the wage earner; if to the person, it is available only to him, if to the claim, it passes with the transfer to the assignee. * * * Regarding, then, the plain words of the statute, and no more, they (the descriptive words) seem to be merely descriptive of the nature of the debt to which priority is given. When one has incurred a debt for wages due to workmen, clerks or servants, that debt, within the limits of time and amount prescribed by the Act, is entitled to priority of payment. *The priority is attached to the debt and not to the person of the creditor; to the claim and not to the claimant.* The Act does not enumerate classes of creditors and confer upon them the privilege of priority in payment, but, on the other hand, enumerates classes of debts as 'the debts to have priority' * * *. These debts were exactly within the description of those to which the Bankruptcy

Act gives priority of payment, and they did not cease to be within that description by their assignment to another. The character of the debts was fixed when they were incurred and could not be changed by an assignment. They were precisely of one of the classes of debts which the statute says are 'debts to have priority.'" (Parenthetical matter and italics ours.)

In *In re Bennet, Trustee of the Hume Cooperage Co.*, 156 Fed. 173; 18 Am. B. R. 320, the Circuit Court of Appeals for the Sixth Circuit, in discussing the rights of an assignee of a prior claim, said:

"Inasmuch as the contingent right of lien under 2487 does not depend upon the doing of any thing by the creditor, there is no reason why a priority or lien which attaches to the claim rather than the claimant, shall not be assignable."

The Court then proceeded to follow the rule laid down in *Shropshire, Woodliff Co. v. Bush,* 204 U. S. 186, also referring to *Trust Co. v. Walker,* 107 U. S. 596, and *Buchanan v. Bowen,* 111 U. S. 776.

There are a multitude of authorities holding that the rights of creditors and the jurisdiction of the Bankruptcy Court *in rem* is acquired as of the date of the filing of the petition: See:

Acme Harvester Co. v. Beckman, 222 U. S. 300, 27 Am. B. R. 262;

Everett v. Judson, 228 U. S. 74, 30 Am. B. R. 1;

Fairbanks Steam Shovel Co. v. Wills, 240 U. S. 642, 36 Am. B. R. 754;

Hiscock v. Varick Bank, 206 U. S. 28, 18 Am. B. R. 1.

And there are also a multitude of authorities holding that the status of priority is unaffected by assignment, either

before or after bankruptcy, which we do not propose to set out at length here.[1]

The case of *Howe v. Sheppard,* 2 Summ. 133, cited by the United States attorney is not in point on the most material fact involved in this proceeding. In the case at bar, at the date of the filing of the petition the bankrupt was not indebted to the United States or to the Federal Housing Administrator acting on behalf of the United States, in any amount at all. It was indebted to the Seaboard National Bank.

In the case of *Howe v. Sheppard,* cited by the Government, the decedent at the time of his death was actually indebted to the United States Government. The facts, as set out in the United States attorney's brief, point out that the judgment against Wood was obtained by Howe and Howard in the sum of $4,663.31 prior to September, 1830. It was assigned to the United States Government in September, 1830. In December, 1830 the United States holding this assignment, brought an action against Wood on the judgment, in the name of Howe and Howard. The action was continued from time to time until October, 1834, at which time Wood died. There is no dispute as to the fact that in October, 1834 when Wood died, he was indebted to the United States Government on a debt which it had owned and held against him in the form of a judgment for a period in excess of three years. Such is not the case here, and we respectfully submit that the case of *Howe v. Sheppard* is not applicable.

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[1]*Matter of Dutcher,* 213 Fed. 908, 32 Am. B. R. 545 (Dist. Ct. Wash.); *Fuller v. Bennett,* 152 Fed. 538, 18 Am. B. R. 443 (Dist. Ct. W. Va.); *Matter of Harmon,* 128 Fed. 170, 11 Am. B. R. 64 (Dist. Ct. W. Va.); *Re Campbell,* 102 Fed. 686, 4 Am. B. R. 535 (Dist. Ct. Wis.); *In re North Carolina Car Co.,* 127 Fed. 178, 11 Am. B. R. 588 (Dist. Ct. N. C.); *In re Partridge Lumber Co.,* 215 Fed. 973, 33 Am. B. R. 539.

The Question of Sovereignty.

It seems to be the contention of the Government in this case that for us to assert that the acquisition by the United States Government of certain claims against the estate of a bankrupt and the enforcement of them, to the detriment of other creditors, would be a manifest injustice to other creditors, would be placing a strained construction upon the rule allowing the Government priority. This can be best answered by pointing out that in the case apparently most relied upon by the Government this very thing occurred. We refer to the fact that in the case of *Howe v. Sheppard,* the Government, by one means or another, acquired a private judgment which would have, but for the Government's acquisition of it, been a general claim against his insolvent estate prior to his death and then proceeded, to the exclusion of the other creditors, to satisfy itself. In these days of heavy income taxes it is a common thing for the Government to levy on property of income tax payers for unpaid income taxes and heavy penalties. It is not beyond the range of probability that if the rule sought here by the Government is sustained, the Federal Government could levy upon general unsecured claims on file in the bankruptcy proceedings where the estate would pay less than a hundred cents on the dollar, acquire possession of them by virtue of that levy after bankruptcy, and then proceed to enforce them in full against the bankruptcy estate, notwithstanding the fact that at the date of the filing of the petition they were ordinary provable claims. Such a situation is not a mere ephemeral or transitory possibility, but is an ever present probability.

In this day and age the activities of the Federal and State Governments are being expanded daily into the realm of private business to an extent unknown to the common law and unheard of at the time of the foundation of this Government. With rapidly changing economic conditions many of these governmental activities may seem necessary, and the writer of this brief has no desire to criticize or quarrel with this policy. We do, however, believe that where the Government engages in purely private enterprise, such as the lending of money to private borrowers, the insuring of accounts receivable and of mortgages, and other similar activities, either in aid of or in competition with private banking or insurance business, and permits its funds and property used in connection with such activities, to be taxed by the States, and permits its officers and agents, either individual or corporate, to sue and to be sued, and pays interest on the funds to the agency carrying out the activity, it has so far abdicated its sovereignty in that respect as to place it on a level with the other creditors of the beneficiary of the Government's aid who likewise loans money or delivers merchandise to the debtor.

In *Sloan Shipyards Corp. et al. v. United States Shipping Board Emergency Fleet Corporation, et al.,* 258 U. S. 459, 42 Sup. Ct. 386, 48 Am. B. R. 249, the Supreme Court of the United States, speaking through Mr. Justice Holmes, said:

> "These provisions sufficiently indicate the enormous powers ultimately given to the Fleet Corporation. They have suggested the argument that it was so far put in place of the sovereign as to share the immunity of the sovereign from suit otherwise than as the

> sovereign allows. But such a notion is a very dangerous departure from one of the first principles of our system of law. The sovereign properly so called is superior to suit for reasons that often have been explained. But the general rule is that any person within the jurisdiction always is amenable to the law. If he is sued for conduct harmful to the plaintiff his only shield is a constitutional rule of law that exonerates him. Supposing the powers of the Fleet Corporation *to have been given to a single man,* we doubt if any one would contend that the acts of Congress and the delegations of authority from the President left him any less liable than other grantees of the power of eminent domain to be called upon to defend himself in court. An instrumentality of government he might be and for the greatest ends, but the agent, because he is agent, does not cease to be answerable for his acts. Osborn v. Bank of United States, 9 Wheat. 738, United States v. Lee, 106 U. S. 196. The opposite notion left some traces in the law (1 Roll. Abr. 95, Action sur Case, T.), but for the most part long has disappeared."

In the *Matter of the Eastern Shore Ship Building Corporation, Bankrupt,* 274 Fed. 893, 48 Am. B. R. 110, ruled upon at the same time by the Supreme Court on certiorari, the United States Circuit Court of Appeals for the Second Circuit, said:

> "When the United States enters into commercial business, it abandons its sovereign capacity and is to be treated like any other corporation. Although it absolutely owns the Panama Railroad Company, and is the only person profiting or losing by its activities, still the railroad company sues and is sued just like any other corporation, in its own name."

Elsewhere in the opinion we find the following significant statement:

> "But surely the fact that the Fleet Corporation was employed as an agency of the President does not of itself clothe the agency so employed with the immunities of his office. A bank organized under the National Bank Act and employed by the Secretary of the Treasury under the act as a depositary of public money and, to use the language of the act, as 'a financial agent of the government' does not on that account lose its character as a private corporation, and does not become immune from suit."

In both cases the Court held that the Emergency Fleet Corporation's claims were not entitled to priority, notwithstanding the fact that the Emergency Fleet Corporation was admittedly an agency of the Government.

In the *United States Bank v. Planters Bank of Georgia*, 9 Wheat. 904, 6 L. Ed. 244, the Supreme Court, speaking through Chief Justice Marshall, said:

> "It is, we think, a sound principle that, when a government becomes a partner in any trading company, it divests itself, so far as concerns the transactions of that company, of its sovereign character, and takes that of a private citizen. Instead of communicating to the company its privileges and its prerogatives, it descends to a level with those with whom it associates itself, and takes the character which belongs to its associates, and to the business which is to be transacted. * * * The state of Georgia, *by giving to the bank the capacity to sue and be sued,* voluntarily strips itself of its sovereign character, so far as respects the transactions of the bank, and waives all the privileges of that character."

As was pointed out by the Court in the *matter of the Eastern Shore Ship Building Corporation, Bankrupt, supra.* the Government, in the case at bar was and is not engaged in any activities "peculiarly governmental in its nature", but is engaged in an activity which is, to use the words of the Court, "commercial and industrial". This activity is being carried out by an individual agent, namely: "the Federal Housing Administrator on behalf of the United States of America", as the title of this appeal indicates. According to the opinion of the Supreme Court in *Sloan Shipyards Corporation, et al. v. United States Shipping Board Emergency Fleet Corporation, et al.,* though the Federal Housing Administrator may be "an instrumentality of government for the greatest of ends, he is but an agent, does not cease to be answerable for his acts", and is not entitled to priority any more than any other private person.

We would also like to direct the Court's attention to the fact that in the *Sloan Shipyards* case, although there was a dissenting opinion by Chief Justice Taft, concurred in by Mr. Justice Van Devanter and Mr. Justice Clarke, regarding the necessity of bringing action against the Emergency Fleet Corporation in the Court of Claims, the dissenting justices were careful to qualify their dissent so as not to include the question of priority. We quote the saving clause in the dissenting opinion:

> "As to the preference claimed against a bankrupt in No. 526 by the Fleet Corporation, I concur in the conclusion of the court that it cannot be allowed under the statute as to preferences in bankruptcy because I do not think it extends to claims of the United States *except those for taxes.*"

See, also, *United States v. Wood,* 290 Fed. 109, 1 Am. B. R. (N. S.) 44. Affirmed by the Supreme Court of the United States later in 263 U. S. 680.

Conclusion.

We believe that the position of the trustee in this matter is correct, both from the technical standpoint and on the equities. The amount involved in this case is small, but so far as we have been able to ascertain this is a test case of some of the recent social legislation on which no Appellate Court has as yet passed, as is evidenced by the request of the district judge that this decision be appealed from in order to settle several pending cases.

To permit the Government to successfully assert priority in this case will work a manifest injustice to creditors, not so much in this case, because of the small amount involved, but in future cases where the principle will be applied. Already creditors of insolvent estates are finding themselves daily confronted with heavy public claims for unpaid Federal and State income taxes, unpaid excise taxes, unpaid sales taxes, license taxes, corporation franchise taxes, and priorities in general, until there is nothing left but the bones of the skeleton on which the general creditors are permitted to feed.

It is becoming more and more common, in our bankruptcy experience, for the priorities to eat up substantial estates, to an extent that is really serious. We do not believe that this Court can extend priority rights to the Government in this case, beyond those accorded by the referee and the district judge, without placing a strained construction on Section 57 (i) of the Bankruptcy Act, and without an extremely liberal construction of the Government's powers when it invades the field of private business. We feel that a reasonable construction of Section 57 (i) of the Bankruptcy Act gives the Federal Housing Administrator the same rights as those held by

the Seaboard National Bank at the date of the filing of the petition, namely: to the allowance of a general unsecured claim. We also feel that the Government has not complied with the law, in filing the claim of the Federal Housing Administrator in his own name and on behalf of the United States, where Section 57 (i) of the Bankruptcy Act requires that the claim be filed *in the name of the creditor.*

In the event this Court rules, as did the referee and the district judge, that the Government is entitled to no more priority than was the Seaboard National Bank, and the Government loses its money upon other unsecured claims where the borrower went into bankruptcy, such result would be unfortunate indeed, but in no way comparable with the calamity befalling the private individual who, in good faith, loaned his money or sold merchandise on credit and afterwards had his debtor take out a Federal Housing Act unsecured loan from a bank compelled to helplessly watch the assets of the debtor's estate go in their entirety, to the Government because it guaranteed the loan made by a bank to the bankrupt.

We respecfully submit that, from the viewpoint of both public policy and justice, the judgment of the District Court should be affirmed.

Respectfully submitted,

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